



Billing Code: 8025-01

## SMALL BUSINESS ADMINISTRATION

### Small Business Investment Companies – Early Stage SBICs

AGENCY: U.S. Small Business Administration

ACTION: Call for Early Stage Fund Managers

SUMMARY: This call for proposals (“Call”) invites experienced early stage fund managers to submit the preliminary materials discussed in Section II below, in the form of the Small Business Investment Company (“SBIC”) Management Assessment Questionnaire (“MAQ”), for consideration by the Small Business Administration (“SBA”) to be licensed as Early Stage Small Business Investment Companies. Licensed Early Stage SBICs may receive SBA-guaranteed debenture leverage of up to 100 percent of their Regulatory Capital, up to a maximum of \$50 million. However, Early Stage SBICs may, and most existing Early Stage SBICs do, request less than 100 percent of their Regulatory Capital. Importantly, Early Stage SBICs must invest at least 50% of their investment dollars in early stage small businesses. For the purposes of this initiative, an “early stage” business is one that has never achieved positive cash flow from operations in any fiscal year. By licensing and providing SBA guaranteed leverage to Early Stage SBICs, SBA seeks to expand entrepreneurs’ access to capital and encourage innovation as part of President Obama’s Start-Up America Initiative launched on January 31, 2011. More information on the Early Stage SBIC Initiative and the regulations governing these SBICs may be found at [www.sba.gov/inv/earlystage](http://www.sba.gov/inv/earlystage).

DATES: The following table provides the key milestones for the Early Stage SBIC Initiative.

Milestones	Dates/Times
<b>MAQ Submission Period/Initial Review</b>	
Management Assessment Questionnaires (“MAQs”) may be submitted at any time between the following dates:	5 p.m. EST—April 1, 2016 – September 30, 2016 Applications considered as they are received
<b>Licensing</b>	
Funds have 12 months from issuance of a Green Light to submit their license application	Applications considered as they are received

ADDRESSES: Visit [www.sba.gov/inv/MAQ](http://www.sba.gov/inv/MAQ) to download a copy of the Management Assessment Questionnaire (the “MAQ”). You must submit via express or next day delivery service (i) the relevant MAQ signature pages and (ii) the completed MAQ on a CD-ROM in **Word** and **Excel** format to the following:

Scott Schaefer  
Senior Investment Officer  
Office of Investment and Innovation  
U.S. Small Business Administration  
409 3rd St., SW, Suite #6300  
Washington, D.C. 20416

SBA will not accept MAQs in .pdf format or MAQs delivered via regular mail (due to irradiation requirements), or hand delivery or courier service.

#### SUPPLEMENTARY INFORMATION:

##### I. Background Information

SBA invites early stage fund managers to submit the preliminary materials, as discussed in Section II below, in the form of a Management Assessment Questionnaire (“MAQ”) for the formation and management of an Early Stage SBIC. In 2012, SBA introduced the Early Stage Initiative. Early Stage SBICs represent a new sub-category of SBICs that will focus on making investments in early stage small businesses. Go to [www.sba.gov/inv/earlystage](http://www.sba.gov/inv/earlystage) for information on the Early Stage Initiative and links to the

Early Stage SBIC Final Rule (“Final Rule”). This initiative is part of President Obama’s “Start-Up America Initiative” to promote American innovation and job creation by encouraging private sector investment in job-creating startups and small firms, accelerating research, and addressing barriers to success for entrepreneurs and small businesses. In the Final Rule, SBA stated that it intended to allocate \$200 million per year (\$1 billion total) of leverage commitments to Early Stage SBICs over the five year period from Fiscal Year (“FY”) 2012 through FY 2016. The Early Stage initiative is scheduled to terminate at the end of FY 2016. However, in FY 2016 SBA intends to make certain modifications to the Early Stage regulations and make clear SBA’s intent to make the Early Stage program (including issuing new Early Stage licenses and leverage commitments) an ongoing part of the SBIC program.

## II. Management Assessment Questionnaire/License Application Materials

The first required submission in the Early Stage Licensing process is SBA’s MAQ. The MAQ consists of two forms that cover qualitative and quantitative information on the management team, the proposed strategy for the SBIC, the principals’ investment track record, and the proposed fund structure and economics. The MAQ consists of SBA Form 2181 and Exhibits A-F of SBA Form 2182.

Should SBA issue you a “Green Light letter,” you must submit the SBIC License Application, consisting of SBA Forms 2181, 2182 and 2183 (each of SBA Forms 2181 and 2182 updated to reflect any changes), for the final licensing phase. Exhibit O in SBA Form 2183 includes the fund’s limited partnership agreement (“LPA”). Applicants should review this notice for special instructions associated with the LPA for Early Stage SBICs.

### III. Early Stage Licensing Process

There are four stages in SBA's Early Stage Licensing Process: A) Call Period; B) Initial Review; C) Applicant Fundraising and Document Preparation; and D) Licensing. Each of these stages is discussed below.

A. Call Period. This notice signals the start of the FY 2016 Early Stage SBIC call period. Interested parties should download a MAQ from <https://www.sba.gov/content/application-forms>. You should also review the information at [www.sba.gov/inv/earlystage](http://www.sba.gov/inv/earlystage) which includes a list of frequently asked questions ("FAQs") regarding the Early Stage Initiative. If you still have questions regarding the Early Stage process, please e-mail your questions to [erikka.robinson@sba.gov](mailto:erikka.robinson@sba.gov). SBA will endeavor to respond to your question within three business days, depending on volume. SBA may not be able to respond to fund-specific questions or questions that require a legal opinion.

B. Initial Review. After completing its Initial Review of a submitted MAQ, SBA will issue a Green Light letter to the applicant if it has preliminarily met the evaluation criteria for an Early Stage SBIC, including the vintage year and geographic diversification criteria. The process for SBA's Initial Review is as follows:

1. Submit MAQ. SBA must receive your completed MAQ no later than September 30, 2016. SBA will send a confirmation that it has received your MAQ within three (3) business days of your submission.

2. Due Diligence. SBA will review all MAQs against the evaluation criteria identified in this notice. SBA may engage a contractor to assist in evaluating MAQs received in response to this Call. The Investment Committee (composed of senior

managers from the Office of Investment and Innovation) will consider each MAQ, and if the Investment Committee concludes that the management team may be qualified for an Early Stage SBIC license, the entire team will be invited to SBA Headquarters at 409 Third Street, SW, Washington, D.C. for an interview. Those applicants not invited for interviews will be notified. SBA will provide feedback upon request to applicants not selected for an interview.

3. Interview. SBA's invitation for an interview will identify a 1-hour time block, along with the topics that the applicant should be prepared to address. SBA will conduct interviews at SBA Headquarters.

4. Green Light Letter. Following the interview, the SBA will issue a Green Light letter to an applicant that has met the criteria identified in this notice, as determined by the Investment Committee. Applicants approved by the Investment Committee can expect to receive the Green Light letter via e-mail within a few days of the Investment Committee's decision. The Green Light letter formally invites an applicant to submit its application for an SBIC License. The Green Light letter is only an invitation to proceed to the next stage in the process, not a guarantee that a fund will be issued an Early Stage SBIC license. Those applicants that do not receive a Green Light letter will also be notified by e-mail within a few days of the Investment Committee's decision.

C. Fundraising and Document Preparation. If you receive a Green Light letter, you will need to raise the minimum Regulatory Capital needed to execute your strategy (which can be no less than \$20 million) and submit your completed license application within one year from the date of the letter.

1. Raise Regulatory Capital. An Early Stage SBIC applicant must have signed capital commitments for at least \$20 million in Regulatory Capital prior to filing its license application.

2. SBIC Education. All principals of the Early Stage SBIC applicant must attend a one-day SBIC Regulations training class. This training is held quarterly in Washington, D.C. The purpose of this class is to familiarize principals with the SBIC rules, regulations and compliance procedures. Although an applicant may receive a license before all principals have completed the training, a majority of principals must do so before licensing and all must do so before a licensed Early Stage SBIC will be permitted to draw leverage. Information concerning registration for classes can be obtained at [www.sbia.org](http://www.sbia.org). Certain non-principals such as members of a board of directors may also be required to take the class. In addition, any employees or consultants whom you have assigned to handle regulatory matters or to interact with the Office of Investment and Innovation should attend the class.

3. Finalize Documents & Perform Checklist. The following items must be completed and submitted in order to proceed to the Licensing phase:

Item
Updated SBA Form 2181
SBA Forms 2182 & 2183
At least \$20 million in Regulatory Capital evidenced by signed Capital Certificate in Form 2183 (Exhibit K)
\$25,000 Non-refundable licensing fee

D. Licensing. During this last stage, SBA will review your completed application, perform further due diligence and analysis as needed, and make the final

licensing decision. Applicants must apply within one year of the issuance of their Green Light letter. The process for Licensing is detailed below.

1. SBA acceptance of license application. Upon receipt of the application, SBA will acknowledge receipt by e-mail. Within three business days, SBA will determine whether the application is complete, meets the minimum capital requirements and satisfies management ownership diversity requirements. If so, SBA will send the applicant an acceptance letter. If not, SBA will ask the applicant to resolve the issues identified.

2. Background and Documentation Review. Once the application has been accepted, SBA will forward the fingerprint cards and Statements of Personal History to SBA's Office of Inspector General for processing by the FBI. Following a review of the application and legal documents, SBA will provide the applicant with a "comment letter." Applicants must respond in writing to the comment letter. Applicants should respond as quickly as possible, but in any event within 30 days. Failure to address all comments to SBA's satisfaction will slow down the licensing process. Please note that pre-licensing investments, which SBA must review and approve before they are closed, will also add to the licensing time.

3. Divisional Licensing Committee. After SBA's licensing staff and Office of General Counsel have completed their review, the license application is presented to the Divisional Licensing Committee. This committee is composed of the senior managers of the Office of Investment and Innovation. If approved by the Divisional Licensing Committee, the application is presented to the Agency Licensing Committee which consists of certain senior managers of SBA. Prior to consideration by the Agency

Licensing Committee, an applicant must provide a signed, up-to-date capital certificate showing that it has at least \$2.5 million in Leverageable Capital, consisting of cash on deposit, approved pre-licensing investments funded with partners' contributed capital, and/or approved organizational and operational expenses paid out of partners' contributed capital, and at least \$20 million in Regulatory Capital. The applicant's bank must certify that the requisite funds are in the applicant's account and unencumbered.

4. Agency Licensing Committee and Administrator Approval. If the Agency Licensing Committee recommends approval of your license application, it will be forwarded to the SBA Administrator or her designee for final action as soon as you submit fully executed copies of all legal documents. (Please note that your counsel must certify that the executed documents are identical to the "final form" of the documents approved by SBA.) If the Administrator or her designee approves your application, your Early Stage SBIC license is issued.

5. Leverage Commitments. As noted above, the Early Stage initiative is scheduled to terminate at the end of FY 2016, but during FY 2016 SBA intends make certain modifications to the Early Stage regulations and make clear SBA's intent to continue making Early Stage leverage commitments to current and newly licensed Early Stage SBICs.

#### IV. Early Stage SBIC LPA and Organizational Instructions

A. Early Stage SBIC Model LPA. In order to expedite the review of Early Stage SBIC license applications, SBA has adopted a Model Early Stage SBIC Limited Partnership Agreement ("Model LPA"). The Model LPA includes required provisions shown in Bold Arial type and optional provisions in a different font. Please e-mail SBA



at [erikka.robinson@sba.gov](mailto:erikka.robinson@sba.gov) for the appropriate version of the Model LPA. Applicants must use the Model LPA as a template and must follow the organizational structure of the Model LPA. Further, applicants must include in their limited partnership agreements all of the required provisions of the Model LPA that appear in Bold Arial type. SBA will not accept additions, deletions and other changes or modifications to any of those required provisions. Applicants are required to submit a copy of their limited partnership agreement blacklined against the Model LPA, as explained in the instructions provided at the beginning of the Model LPA. SBA provides the following further guidance on limited partnership agreements:

1. SBA encourages applicants to adhere to the Model LPA to the maximum extent possible. The entire agreement is subject to SBA's approval.
2. Conditions or restrictions on the ability of the general partner to call private capital commitments are limited to those permitted by the Model LPA.
3. Withdrawal rights are limited to those permitted by the Model LPA.
4. Applicants must adhere to SBA's management fee policies available at <http://www.sba.gov/sites/default/files/files/SBICTechnote07arev200804.pdf>. This policy sets a *maximum* allowable management fee only. The actual management fee will be set by negotiation between the management team and the limited partners and may be less than the maximum. Early Stage SBIC applicants should be aware that the calculation of an SBIC's capital impairment percentage is affected by all fund expenses, including management fees. SBA will consider the management fee in its licensing evaluation criteria as part of fund economics. SBA believes that the primary incentive for fund managers should be carried interest rather than fees.

5. The designation of fund expenses and expenses to be paid out of the management fee must be consistent with SBIC program regulations (see 13 CFR 107.520) and policies.

a. Organizational costs, expenses incurred in applying for a license and forming the SBIC and its entity general partner (but not its parent fund or any other affiliate), are considered a partnership expense. Organizational expenses typically include items such as the licensing fee, cost of legal and other professional and consulting services, travel and other fundraising expenses, costs of preparing, printing and distributing the private placement memorandum or other offering materials, and other related expenses such as telephone and supply costs. SBA strongly encourages, and may require, applicants to include in the LPA a reasonable cap on the total organizational costs to be paid by the applicant. Costs that SBA deems excessive can be paid by an affiliate of the applicant or deducted from the applicant's Regulatory Capital prior to licensing (Regulatory Capital must still be at least \$20 million after the deduction).

b. Unreimbursed expenses on investments in small businesses that do not close may be designated as a partnership expense but must be capped at a reasonable level.

6. Right of limited partners to remove general partner – Provisions allowing removal of the general partner without cause ("no-fault divorce" provisions) are permitted only after the Early Stage SBIC has repaid all outstanding leverage and any other amounts payable to SBA and has surrendered its SBIC license.

7. Any amendments to the limited partnership agreement required by SBA must be executed before licensing. Any amendments initiated by the applicant during the licensing process must be submitted to SBA in draft form as early as possible.

B. Organization. Early Stage SBIC applicants must adhere to the following rules regarding organizational structure:

1. Applicant cannot be a BDC or other public entity or a subsidiary of any such entity.

2. All provisions governing the operation of the SBIC must be included in the limited partnership agreement. While SBA does not encourage the use of side letters, SBA recognizes that side letters form the basis of the understanding of the investment in an SBIC for certain investors, and, in particular, certain investors subject to regulatory oversight. If an investor requests a side letter provision that is of general interest to all investors (e.g., a provision regarding the fund's efforts to invest in certain geographic areas), that provision should be incorporated into the limited partnership agreement. Any provision of a side letter that purports to control, alter or supplement a section of the partnership agreement must expressly identify each such section. If a side letter fails to expressly identify any such section, SBA will consider the conflicting provision of the side letter to be without force or effect. All side letters require SBA's prior written approval.

3. Applicant must adopt SBA Model Valuation Guidelines.

4. Drop-down SBICs

a. The drop-down structure should be used only when it has a clear business purpose:

i. Example 1 – Parent fund has already raised capital and begun operating and wants to commit a portion of its capital to an Early Stage SBIC.

ii. Example 2 – Substantial capital will be retained for investment at the parent level (SBA suggests that managers consider the alternative of structuring a non-SBIC fund side by side with the SBIC).

b. Drop-down funds must have one parent fund only and the parent fund must be a U.S. entity.

c. Parent must qualify as a traditional investment company based on established SBA precedent.

d. Parent must disclose the identity of all of its investors.

e. All of the investors in the parent fund (the SBIC's "Class A" limited partner) must agree to be "Class B" limited partners of the SBIC with an obligation to fund the Early Stage SBIC capital calls if the Class A limited partner does not. The obligation of the Class B limited partners to the Early Stage SBIC is reduced dollar for dollar as the parent fund contributes capital to the SBIC. The Model LPA contains required provisions for drop-down funds.

f. The Class B limited partners' commitments to the SBIC applicant must be expressed as a specific dollar amount (not just as the "proportionate share" of parent fund's commitment).

g. The total dollar amount of Class B commitments must be equal to the Class A limited partner's unfunded commitment to the SBIC. SBA will not require Class B commitments if the SBIC's Regulatory Capital will not include any unfunded commitments from the Class A limited partner.

C. Capitalization. Applicants must raise the minimum \$20 million in Regulatory Capital by the time the license application is submitted.

1. Capital commitments from limited partners must be made directly to the SBIC (and its parent fund, in the case of a drop-down) with no intermediaries involved.

2. The Early Stage SBIC applicant must have the unconditional ability to legally enforce collection of each capital commitment.

3. Capital Certificate. Capital commitments must be documented in the capital certificate (Exhibit K of SBA Form 2183) and comply with the following:

a. A signed Capital Certificate must be submitted with the license application.

b. SBA will permit only the sole following condition on private capital commitments: the receipt of an Early Stage SBIC license.

c. Individual investors must list primary residence address, not a business address.

d. Street addresses are required (no P.O. Box addresses).

4. A dual commitment may be obtained to back up the commitment of any direct investor in the SBIC who is not an Institutional Investor.

5. Capital commitments by the principals, general partner, or their affiliates must be payable in cash when called (cannot be satisfied with notes or management fee waivers).

D. General Partner

1. All principals must:

a. Hold direct ownership interests in and be the direct individual managers of the general partner, with no intervening entities.

b. Receive carried interest directly from the general partner; for drop-down SBICs, carried interest may be received from the parent fund's general partner.

2. A maximum of 25% of the carried interest may be allocated to non-principals.
3. Any provision to remove or terminate a principal must be spelled out within the general partner's organizational document and must not be tied to events occurring under other agreements (e.g., a principal's employment agreement with the management company).

E. Investment Advisor ("Management Company"). Ownership of the Management Company that is highly disproportionate to the ownership of the general partner (e.g., one principal is the 100% owner) is not viewed favorably by SBA, but may be acceptable if there are adequate checks and balances on the powers of the dominant owner. Areas that cannot be subject to unilateral decision-making include the following:

1. Power to remove or terminate other principals.
2. Power to change the composition of the Early Stage SBIC's investment committee.

V. Early Stage SBIC Licensing Evaluation Criteria.

A. General Criteria. SBA will evaluate an Early Stage SBIC license applicant based on the submitted application materials, Investment Committee interviews with the applicant's management team, and the results of background investigations, public record searches, and other due diligence conducted by SBA and other Federal agencies. SBA will evaluate an Early Stage SBIC license applicant based on the same factors applicable to other license applicants, as set forth in 13 CFR 107.305, with particular emphasis on managers' skills and experience in evaluating and investing in early stage companies. As discussed in the Final Rule, evaluation criteria fall into four areas: A) Management Team; B) Track Record; C) Proposed Investment Strategy; and D) Organizational

Structure and Fund Economics. You should review these regulations prior to completing your MAQ.

B. Managing SBA Leverage. SBA will pay particular attention to how a team's investment strategy works with proposed SBA leverage. Early Stage Debenture leverage either requires a 5 year interest and annual charge reserve from the date of issue or is structured with an original issue discount that covers the interest and annual charges for the first 5 years. In either case, Early Stage SBICs must identify how quarterly interest payments beginning in the 6<sup>th</sup> year from Debenture issue will be met. Sources of liquidity to make interest payments may include a) private capital; b) realizations; or c) current income. As part of your plan of operations, you should carefully consider how your investment strategy will work with SBA leverage and make appropriate suggestions to manage risk. Risk mitigation strategies might include making some investments in current pay instruments, taking down less than a full tier of leverage (i.e., leverage less than 100% of Regulatory Capital), taking leverage down later in the fund's life, lowering management expenses, and reserving more private capital. The strategies you choose to employ should be appropriate for your management team's track record and investment strategy.

C. SBA Diversification Rights. Per 13 CFR 107.320, SBA reserves the right to maintain diversification among Early Stage SBICs with respect to (i) the year in which they commence operations ("vintage year") and (ii) geographic location.

1. Vintage Year Diversification. Vintage year has a major impact on the return expectations of a fund and excessive concentration in a single year could substantially increase program risk. Therefore, SBA reserves the right, when licensing Early Stage

SBICs, to maintain diversification across vintage years. If SBA receives an extraordinary number of qualified applicants in FY 2016, it may not approve all such applicants in the same Fiscal Year.

2. Geographic Diversification. All Early Stage SBICs must first meet SBA's basic licensing criteria. After those criteria are met, SBA reserves the right to maintain diversification among Early Stage SBICs with respect to the geographic location in which the Early Stage SBIC expects to invest.

Michele Schimpp,  
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Office of Investment and Innovation

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